STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

TDS Metrocom, LLC	**)**	
-vs-	**)**	
Illinois Bell Telephone Company	**)**	
	)	**03-0553**
Complaint concerning imposition of unreasonable	**)**	
And anti-competitive termination charges by	**)**	
Illinois Bell Telephone Company.	**)**	

REPLY BRIEF OF SBC ILLINOIS

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Illinois Bell Telephone Company ("SBC Illinois" or "the Company"), by its attorney, hereby files its Reply Brief in response to the Initial Briefs filed by TDS Metrocom, LLC ("TDS") and the Commission Staff ("Staff") in the above-captioned proceeding.

I. INTRODUCTION

The positions taken by TDS and Staff in their Initial Briefs gloss over all of the policy and factual issues raised by SBC Illinois in response to their testimony filed in this proceeding. Both assume that the Commission's decision in the *Ascent* proceeding should guide the result in this proceeding – ignoring the fact that the *Ascent Order* was directed at a specific set of products and services, reflected marketplace conditions in the 1996-98 time frame and involved a 100% termination liability policy that SBC Illinois has not utilized since 2002. The world is completely different today. Whatever merit the *Ascent* approach might have had based on the record in *that* proceeding, the record in *this* proceeding is altogether different: the products and services at issue are much broader (and many of them have been competitive for a long time), the marketplace today is much more competitive and SBC Illinois' termination liability policy has been substantially modified. Neither TDS nor Staff have come close to making a case that SBC Illinois' current termination liability policies are unlawful or that the approach preferred by TDS and Staff (i.e., the "give-back-the-unearned-discount" methodology) is even competitively superior to SBC Illinois', much less the only lawful approach that can or should be used.

Fundamentally, TDS and Staff are caught in a time warp. They are urging that Commission micromanage terms and conditions applicable to competitive services offered by SBC Illinois and other carriers. This kind of regulatory oversight can be justified – if at all – only when competition is just emerging and customers are not yet able to make informed competitive choices. No such circumstances exist here. It is clear from the record and the actions of the Commission that the Illinois marketplace is open. There are numerous vendors from which customers can choose. Business customers in particular – the only customers impacted by the termination liabilities at issue in this proceeding – are sophisticated and capable of making their own decisions. The mere fact that TDS and Staff might prefer a different termination liability structure than the one SBC Illinois and every other carrier in the marketplace uses does not warrant regulatory intervention.

Staff recommends a rulemaking proceeding to impose a consistent termination liability policy on *all* carriers in Illinois. SBC Illinois appreciates Staff's recognition that an even-handed approach is required. However, this proposed proceeding is fundamentally inappropriate and unnecessary. One of Staff's principal concerns is that a rulemaking proceeding is necessary to avoid future complaints on this same subject. However, if the Commission makes clear to the industry *now* that it expects carriers to compete in the marketplace, not in the hearing room, that should put an end to these types of complaints.

Most of the issues raised by TDS and Staff were addressed in SBC Illinois' Initial Brief and they will not be repeated here. However, an additional response is hereby provided to certain contentions made by the parties in their Initial Brief.

II. TDS' TERMINATION LIABILITY POLICY SHOULD NOT BE IMPOSED ON SBC ILLINOIS

A. SBC ILLINOIS' TERMINATION LIABILITY POLICIES ARE REASONABLE

TDS contends that the Commission should impose TDS' version of termination liabilities on SBC Illinois because the Commission concluded in the *Ascent Order* that it met the fundamental legal principles applicable to such charges. TDS Initial Brief at 16. That is, that a termination charge provision must bear a reasonable relationship to the loss or damage suffered by the seller and must take into account the costs that the seller avoids by not having to provide the product or service for the remainder of the contract term. *Id.* at 15.

These are standard principles of contract law and are by no means unique to this industry or these term agreements, and the *Ascent Order* does not suggest otherwise. The fact that the Commission found the "give-back-the-unearned-discount" approach lawful in the *Ascent* proceeding does not mean that it is the *only* lawful approach. As SBC Illinois explained in this proceeding, it no longer utilizes the 100% termination liability policy that the Commission rejected in 2002. It also demonstrated that its new policies are fully consistent with the principles set out in the *Ascent Order*: i.e., they *do* bear a reasonable relationship to the losses SBC Illinois suffers when customers terminate early and they *do* take into account the costs it avoids by not having to provide service over the remainder of the contract period. TDS has confused a finding that the approach it prefers is *a* lawful methodology with a finding that it is the *only* lawful methodology. The Commission reached no such conclusion. In effect, the Commission was faced with a "baseball arbitration" situation in the *Ascent Order*: the only two options in the record were SBC Illinois' 100% liability policy and some version of "give-back-the-unearned-discount." The Commission did not consider, and did not rule on, any other methodologies.

Indeed, subsequent events make clear that both the Commission and the Commission Staff understood that the *Ascent Order* had very limited application. In the face of unsuccessful efforts by Staff to persuade the other Illinois CLECs to reduce their "forward-looking" termination liabilities to 50% of what remained on the contract, the Commission took no further action. SBC Illinois has continued to file numerous tariffs with "forward-looking" termination liabilities at a 35% or 50% level and these tariffs have all been passed to file. SBC Ill. Ex. 1.1 (Gillespie Direct) at 10-11; Sch. BG-R2. The Commission would presumably not have permitted these tariffs to go into effect if a "give-back-the-unearned-discount" methodology were the only way to meet the standards in the *Ascent* case. Indeed, it is hard to imagine that the Commission could find forward-looking termination liabilities to be inherently unlawful, since they are the standard in the industry.

TDS contends that SBC Illinois' new policies are unacceptable because the termination charges are "still too high and will significantly limit any switching by business customers taking service from SBC Illinois under term contracts and multi-year tariff plans." TDS Init. Br. at 17-18. However, TDS ignores the fact that *its* approach also produces large termination liabilities – they just kick in later in the contract period. For example, for a typical 36-month Centrex agreement (with a 25% termination liability), the highest possible termination liability under SBC Illinois' approach is $5,688 (*i.e.,* if the customer were to terminate the agreement in month 1 of the 36-month term). In contrast, the highest possible termination liability under TDS' approach is *$12,250* (*i.e.,* if the customer terminates the agreement in month 35 of the 36-month term). This is more than twice as high as SBC Illinois'. Nor is this just a function of month 1 vs. month 35. At the midpoint of the agreement (*i.e.*, month 18), a customer would pay $2,925 in termination liabilities under SBC Illinois' approach and *$6,300* under TDS' approach. SBC Ill.

Ex. 2.1 (Frankel Rebuttal), Sch. AF-R2. The pattern is somewhat different for DS-1 service, because SBC Illinois' termination liability is higher (i.e., 50%). The month 1 termination liability under SBC Illinois' approach is $2,179.80, while the month 35 termination liability under the TDS approach is $846.64. However, at the 18-month midpoint, TDS' approach produces a higher amount than SBC Illinois': $1,854.92 vs. $1,121.04. SBC Ill. Ex. 2.1 (Frankel Rebuttal) at Sch. AF-R1. Usage agreements would fall in between the two, because they carry a 35% termination liability.

In short, the financial analyses simply do not support TDS' claim that "give-back-the-unearned-discount" is the only reasonable methodology. The size of the termination liabilities produced by these two approaches varies by product and service and by when during the agreement the customer terminates (i.e., early vs. late). However, it is *impossible*, based on the record in this proceeding, to find that SBC Illinois' approach produces termination liabilities that are "too high" in any absolute sense compared to TDS'.

TDS suggests that the 25%/35%/50% profit margins on SBC Illinois' services implied by these termination liabilities are inconsistent with a competitive marketplace. TDS Init. Br. at 18. TDS is incorrect. Nothing in the record establishes benchmarks for a profit margin on competitive services or demonstrates that these amounts are "too high." SBC Illinois incurs shared and common costs that must be recovered in the "contribution" (or profit margin) on retail products, because there is no formal shared and common cost mark-up as there is for wholesale products. See e.g., *Order in Docket No. 02-0864*, adopted June 9, 2004, at 222. Moreover, profit margins on retail services are significantly impacted by the Commission's retail cost of service rules. 83 Ill. Adm. Code § 791. For example, the cost of service rule requires the assumption that network facilities are fully utilized, with the exception of spare capacity for administration and maintenance. 83 Ill. Adm. Code § 791.20(n). As recognized at length in the Commission's Order in the UNE proceeding, SBC Illinois incurs costs associated with spare capacity. *Order in Docket No. 02-0864*, adopted June 9, 2004, at 58-59. Because spare capacity is not included in LRSIC costs, it must be recovered in contribution. Thus, there is no evidence that 25%/35%/50% profit margins are "too high" relative to the costs that need to be recovered in SBC Illinois' overall rate structure. TDS is noticeably silent on *its* profit margins for these services.

Finally, TDS contends that the mere fact that relatively few customers switch providers during a term agreement demonstrates that SBC Illinois' termination liabilities are too high. TDS Init. Br. at 14. TDS is incorrect. An equally plausible interpretation of the data is that customers are generally satisfied with the service that they obtain from SBC Illinois and are not inclined to break their contractual commitments early. SBC Ill. Ex. 1.0 (Gillespie Direct) at 37-38. Notably, TDS provided no evidence that *its* customers terminate their term agreements early at a higher rate than SBC Illinois'.

B. SBC ILLINOIS SHOULD NOT BE REQUIRED TO CALCULATE TERMINATION LIABILITIES FOR CLECS

TDS continues to argue that SBC Illinois should be required to calculate termination liabilities directly for CLECs. TDS Init. Br. at 20-21. TDS contends that the mere fact that the CLEC has a written agency authority automatically obligates SBC Illinois to perform these calculations. TDS Init. Br. at 21. TDS does not cite to any existing Commission authority to support this proposition. Although agency letters are used for certain purposes in the telecommunications industry (e.g., to support requests to change providers submitted on behalf of retail customers by carriers), these requirements are narrowly targeted and have generally followed extensive regulatory proceedings.[1] No such general obligation exists here.

Indeed, TDS' reliance on Finding (10) of the *Ascent Order* hurts its position, not helps it. TDS Init. Br. at 19-20. If SBC Illinois were legally obligated to perform such calculations for CLECs just because they have an agency letter, there would have been no need for Finding (10) at all. SBC Illinois would have been required to do this work for CLECs as a matter of course. Similarly, there would have been no need for the Ohio Commission to impose a calculation obligation on SBC Ohio as CLECs first entered its local market. The fact that the Illinois (and Ohio) Commissions concluded that such a requirement was necessary to achieve certain objectives when the marketplace was just becoming competitive cannot be converted into a legal obligation that is never-ending.

TDS contends that relying on customers to make the request is problematical. TDS argues that "the customer (particularly a busy small business customer) may simply fail to follow up to make or pursue the request with SBC." TDS Init. Br. at 21. This directly supports SBC Illinois' contention that many of the CLEC-generated requests involve customers who have little or no real interest in changing providers. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 9-10. If the customer is not interested enough to even make the request of SBC Illinois, then the Company is performing calculations for CLECs that are on fishing expeditions. This is inappropriate.

TDS also argues that CLECs are more likely to present focused requests to SBC Illinois than customers, not less likely. TDS Init. Br. at 22. This is mere assertion that is not based on record evidence. Ms. Kent processes these CLEC requests and, based on her experience going

[1] See e.g., 220 ILCS § 13-902(d), which mirrors the PIC change rules adopted by the FCC after extensive rulemaking proceedings. Notably, SBC Illinois has no *legal obligation* to perform these calculations even for its own customers. This is simply the Company's practice. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 9. CLECs cannot bootstrap a practice into a legal obligation.

back numerous years, responding to CLEC requests is more complex and time-consuming than responding to customer requests, not less. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 5-6. Whatever TDS believes the situation *should be*, the facts are otherwise.

TDS also objects to working through the customer because SBC Illinois would have the opportunity to persuade the customer not to leave. TDS Init. Br. at 22. This is part and parcel of the competitive marketplace. The principal issue is whether the *customer* benefits and the customer would likely be better off if SBC Illinois and TDS can both respond to each other's proposals. In effect, TDS is asking this Commission to erect a wall between SBC Illinois and its own customer to prevent SBC Illinois from meeting or beating TDS' offer.[2] This would be anti-competitive, not pro-competitive, and would not represent appropriate regulatory policy.

Finally, TDS contends that this issue has been ". . .properly disposed of in the electric and gas industry." According to TDS, the Commission would not ". . .for a nanosecond tolerate an electric or gas utility that decided to accept direct access switching requests, gas nominations, billing inquiries and similar requests only from retail customers." TDS Init. Br. at 22. Notably, TDS provided no citations to any Commission orders to support its claim nor has it demonstrated that these functions are comparable to what is at issue in this proceeding. As noted above, SBC Illinois *will* accept requests from CLECs and IXCs to switch customers based on a valid LOA; it also provides CLECs with a substantial amount of customer-specific billing information as part of the pre-ordering processes. *Order in Docket No. 01-0662,* adopted May 13, 2003, at 102-03. These practices appear to be comparable to those cited by TDS for the gas and electric industries. Notably, the CLECs do not calculate termination liabilities for the ILECs when ILECs are pursuing *their* customers. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 12-13. What TDS is asking for

[2] TDS contends that it is important to have accurate termination liability calculations. *Id.* This statement begs the question *how* the CLECs obtain this information.

in this proceeding exceeds the bounds of standard practice in this industry and it should not be required – and certainly not for SBC Illinois alone.

In response to the burden that TDS' proposal would impose on SBC Illinois, TDS magnanimously offers to extend SBC Illinois' response interval from three business days to five business days. TDS Init. Br. at 24. An additional two days accomplishes precisely nothing. An extra month would not accomplish much. There were simply too many CLEC requests for SBC Illinois to process with its existing workforce, *period*. That is why the Company scaled back the services for which it would perform these calculations to the *Ascent Order* requirements. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 7. Similarly, the burden should not be placed on SBC Illinois to develop a series of forms to discourage unfocused or inaccurate CLEC requests. TDS Init. Br. at 24. CLECs should learn how to perform these calculations themselves – as many apparently have – or work through the customer.[3]

C. STAFF'S RULEMAKING PROPOSAL SHOULD NOT BE ADOPTED

Staff's position in its Initial Brief is identical in all respects to its position in direct testimony. SBC Illinois continues to be disappointed that Staff has not taken into account the changes that have occurred in the business marketplace since the services at issue in the *Ascent Order* were introduced, its own prior positions in the workshops conducted in compliance with the *Ascent Order*, or any of the financial analyses submitted by SBC Illinois that demonstrate that TDS' policy is not superior to SBC Illinois'. In support of its preference for the "give-back-the-unearned-discount" approach, Staff even recycles its own hypothetical customer example.

[3] TDS misunderstood SBC Illinois' testimony as to which types of contracts are most difficult to calculate termination liabilities for. TDS Init. Br. at 23, n. 8. Ms. Kent stated that the "give back the unearned discount" calculation on *usage plans* like CompleteLink are difficult because every individual call made during each month during the period that the *Ascent* termination liability applies must be re-rated. Under the *Ascent Order*, SBC Illinois will continue to perform these calculations for CLECs. SBC Ill. Ex. 5.0 (Kent Surrebuttal) at 5, 11. This problem has no counterpart in data/transport agreements, where service is billed on a fixed monthly basis. In

Staff Init. Br. at 12. SBC Illinois demonstrated in its Rebuttal testimony that Staff had made a *calculational error*. If this error is corrected, SBC Illinois' methodology produces a lower amount than TDS' methodology for the entire third year of the contract – not just the last few months. SBC Ill. Ex. 2.1 (Frankel Rebuttal) at 9. In addition, there is no one-year option for Centrex service, which is critical to Staff's calculation. Using actual Centrex rates – rather than the hypothetical example constructed by Staff – the customer is better off under SBC Illinois' approach for *24* of the 35 months of the term (or 69%). In other words, SBC Illinois' approach does *not* generally result in a higher termination penalty than the *Ascent* approach and is not more favorable to customers only "during the last few months of a lengthy term contract." Staff Init. Br. at 13. The Commission should not rule in TDS' favor or commence a rulemaking proceeding based on such patently incorrect factual assumptions.

Staff suggests that a rulemaking proceeding is appropriate because the size of the termination liabilities under SBC Illinois' contracts can be "enormous," as they are based on percentages "that are as high as 100%." *Id.* Staff appears to have confused the record in the *Ascent* proceeding with the record in this proceeding. SBC Illinois stopped using 100% termination liabilities in any contracts in *2002*, after the Commission's *Ascent Order* and the workshops.[4] On a going-forward basis, the liabilities are 25%, 35%, or 50% depending on the product family. Therefore, Staff's 100% concern is *not* a basis for a rulemaking proceeding.

Staff contends that the possibility exists that the contracts in question ". . .can result in locking up customers and, thus, can adversely affect the competitive marketplace." *Id.* at 14. Staff provided no evidence to support this proposition, nor did it demonstrate that TDS' proposal

addition, although TDS spends much of the footnote addressing data/transport contracts, it evidenced no interest in them during the proceeding.

does not have this effect. All termination liabilities deter customers from breaking their contractual obligations early and they are *not* anticompetitive. They are a standard component of many industries and they confer benefits on both suppliers and customers. SBC Ill. Ex. 2.0 (Frankel Direct) at 7-12. Moreover, Staff has completely ignored SBC Illinois' substantial evidence that customers are not "locked up" in sufficient numbers or under rigid-enough contracts to constitute any kind of threat to competition. SBC Ill. Ex. 2.0 (Frankel Direct) at 15-24. Mere assertions by Staff are not a basis for granting the relief requested by TDS or commencing a rulemaking proceeding.

The only statement made by SBC Illinois in its Rebuttal testimony which Staff acknowledges at all is the following: "every CLEC in Illinois other than TDS would object violently to any effort to impose TDS' approach on them" through a rulemaking proceeding. Staff Init. Br. at 15-16. SBC Illinois believes this to be true based on the CLECs' conduct in the post-*Ascent* workshops and its own response to this proceeding. Staff then proceeds to confuse the issue by claiming that SBC Illinois had exaggerated the "potential unwillingness of CLECs to participate meaningfully in a termination liability rulemaking." That is *not* what SBC Illinois said. Obviously, the major CLECs would participate in the proceeding because they would not want to have the TDS approach imposed on them "willy nilly." The point SBC Illinois was making is that other CLECs will not support the TDS approach and the Commission would have to impose it on a completely unwilling industry (with the one exception of TDS). SBC Ill. Ex. 1.1 (Gillespie Rebuttal) at 18-19. This is a factor that the Commission should at least consider before embarking on a major regulatory undertaking such as the one Staff is proposing.

[4] Although TDS was incorrectly quoted termination liabilities at the 100% level under some of the older agreements, these quotes were corrected. This is one of the reasons SBC Illinois overhauled its termination liability policies – to reduce likelihood of this kind of mistake. SBC Ill. Ex. 1.0 (Gillespie Direct) at 8, 17.

III. CONCLUSION

In conclusion, neither TDS nor Staff have justified their proposals in this proceeding. TDS' Complaint should be denied and the Commission should not initiate a rulemaking proceeding. Termination liabilities can and will be disciplined by the marketplace and there is no need for regulatory intervention.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I, Louise A. Sunderland, an attorney, certify that a copy of the foregoing **REPLY BRIEF OF SBC ILLINOIS** was served on the parties on the attached service list by U.S. Mail and/or electronic transmission on June 25, 2004.

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